

**Remarks by  
Chairman Sheila C. Bair  
to the  
Housing Association of Non-Profit  
Developers Annual Meeting  
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First, let me congratulate HAND on 19 years of public service in working to expand the availability of affordable housing in the greater Washington, D.C. area. The ongoing mortgage crisis has highlighted the critical importance of affordable housing and stable neighborhoods to the economic security of all Americans.

The Middle Atlantic Region has not escaped the effects of the recession or the housing bust. As you know, mortgage defaults and foreclosures have risen to record levels across the region and throughout the country. And even after the mortgage crisis is over – and we are not out of the woods yet, I'm afraid -- finding affordable housing will continue to be a problem for many people. That's why your work – in developing new ideas, sharing best practices, and accessing new sources of capital – will continue to be essential to our communities.

**Outlook for the economy, housing & mortgages**

Let me give you our take on the current situation. After many months of recession and job losses, the economy is beginning to recover. Though substantial uncertainties remain, we are seeing gradual progress in terms of economic activity, and even signs that payrolls are starting to expand and that bank loan performance is beginning to stabilize. But banks continue to set aside provisions for loan losses, and bank failures continue at an elevated pace. While some of the early bank failures in this crisis included large mortgage lenders that offered risky loan products, we are now dealing with problems among smaller community banks with high concentrations of construction and commercial real estate loans.

Still, during the past year we have seen some welcome signs of stability in many housing markets. Inventories of vacant homes are beginning to shrink, existing home sales are up, and investors have been buying distressed properties even in troubled markets. Home prices have been relatively stable in most parts of the country over the past year, following their historic, 33 percent average decline from mid-2006 through the early part of last year. Federal policy initiatives have been a major factor in stabilizing the housing markets.

But now that many of these programs have expired, where will markets go next? Today, more than 11 million homeowners – or more than one in four of those with a mortgage – are underwater, owing more than their home is worth. At the end March, there were some 2.4 million mortgages in foreclosure, and almost three and a half million more

were at least 60 days past due. Modifications of at-risk mortgages continue to gain momentum. About 640,000 permanent modifications were put in place under Treasury's Home Affordable Modification Program, and other programs, in the first four months of this year. That figure is roughly comparable to the number of mortgages that entered foreclosure over the same period.

But we still have a long way to go until this crisis is behind us. That's why the FDIC continues to encourage investors who buy failed banks under loss-share agreements to be aggressive in preventing needless foreclosures. I am very proud to say that the FDIC was among the first to pursue systematic loan modifications for distressed borrowers in our role as conservator at IndyMac Federal Bank almost two years ago. Despite the relative stabilization in housing markets over the past year, we need to recognize that this battle is not yet won. People out there still need help. And if we turn our backs on them, the problem could get worse once again.

### **The future of mortgage finance**

Even as we grapple with today's problems, we must look to the future. What will it take to assure that future housing cycles do not breed the kind of instability that we have seen in this episode?

Not so long ago, the American system of mortgage finance was the envy of the world. Private institutions, many of them under mutual ownership, followed standards set under government programs and gave us a wonderful financial innovation – the 30-year, fixed-rate, non-callable mortgage. These loans gave borrowers certainty. Homeowners knew what their monthly payments would be, and could plan accordingly. And the government-sponsored enterprises, or GSEs, linked these loans to the global capital markets, creating a secondary market that gave lenders the confidence that their mortgages were truly liquid, bankable assets. These mortgage products and practices helped to lay the foundation for a remarkable period of economic performance in the post- World War II era.

So, how did things go so terribly wrong? In the 1980s, the S&L crisis taught us that institutions that specialize in mortgages are highly vulnerable to interest rate risk. This remains a concern today given the current zero-interest rate environment. As for the GSEs, they were not only successful, but they grew over time to dominate the conforming mortgage market. In the process, they came to wield enormous political influence, and booked huge profits even while socializing the risks that were building up on their balance sheets.

Finally, mortgage securitization went far beyond the GSEs during the lead up to the latest crisis, with private issuers doubling their share of total mortgage debt to more than 20 percent of the market between 2003 and 2006. This two-trillion-dollar river of credit, running right through the heart of Wall Street, provided the financing for most of the subprime and nontraditional loans that triggered the crisis.

But as we go down the list of what went wrong, let me reiterate that this crisis was not caused by the Community Reinvestment Act. Bank regulators are unanimous on that point. To be sure, the CRA encourages banks to make safe and sound loans in the communities they serve. But nowhere does it tell them to make unaffordable, unsustainable loans that set people up for failure. Most of the subprime and high risk nontraditional mortgages were made by non-CRA lenders. And these loans were made in large volumes because for a time they were highly profitable and because Wall Street would buy them and securitize them. It's as simple as that.

## **The way forward**

So what should be done to put our mortgage industry on a sounder footing? I don't claim to have all the answers. But let me make three main recommendations.

The first is to educate and protect the consumer. Somewhere along the line, the industry forgot that the ultimate purpose of mortgage finance is to meet the credit needs of the American people. I'm not saying that it's wrong to earn a profit making mortgage loans. There is, and should be, profit potential in this business – so long as it is carried out in a way which results in sustainable mortgages for consumers. But most consumers are not Wall Street financial wizards. They want simple mortgage structures and straightforward disclosures that are designed to clarify – not obscure – the true nature of the deal.

When consumers lack a clear understanding of the deal, they are more likely to default, as so many consumers have in this crisis who had subprime and nontraditional loans. Financial education can do a great deal to help consumers make informed financial decisions and protect themselves. This is something that all of us can promote through our own outreach efforts.

The FDIC has been promoting financial education for almost a decade with our Money Smart program. Money Smart comes in seven languages, and over two and a half million consumers have made use of it.

We also set up an FDIC Advisory Committee on Economic Inclusion. Chartered in November 2006, the Committee provides the FDIC with advice and recommendations on expanding access to banking services for underserved populations. Its strategic plan is focused on savings, financial literacy, affordable credit, and other key consumer needs. The idea is to engage mainstream financial institutions in these important initiatives by supporting research, developing a supportive policy framework, and, where appropriate, launching pilot projects to test- market new ideas.

My second recommendation to restore our mortgage finance system is to restart securitization – of both conforming and nonconforming loans – but on a much sounder footing. Securitization and the complex financial instruments that surround it have been vilified, rightly in many cases, for triggering the recent crisis.

But in today's world of global finance, securitization remains the best way to tap large volumes of capital at the lowest possible cost. Right now, private securitization of nonconforming loans remains largely shut down. Investors have lost faith in a process where the financial incentives -- between lenders, underwriters, ratings agencies, and investors -- are badly misaligned.

We need a whole new set of transparent market practices. We need higher standards for loan underwriting and documentation. Loan originators need to keep some skin in the game and not be able to walk away from the long-term consequences of their decisions.

The FDIC has a unique opportunity to lead the way in reforming securitization because of a change in the accounting standards that requires us to rewrite the rules that govern how we handle securitized assets in a failed bank receivership. Under our proposal, bank securitization deals would need to meet higher standards for underwriting, disclosure, deal structure, compensation and risk-retention in order to qualify for sale treatment. Our proposal complements similar reforms underway at the SEC, and under consideration by Congress. I believe that these reforms will help restore confidence in these markets, but in a way that promotes long term, sustainable home ownership.

My final recommendation relates to the basic goals and strategies of federal housing policy. For 25 years federal policy has been primarily focused on promoting homeownership and promoting the availability of credit to home buyers. While tax deductions for interest on most forms of consumer debt have been curtailed, the home mortgage interest deduction lives on. Local property taxes are also deductible, as are capital gains up to \$250,000.

The government-sponsored mortgage enterprises, which flourished during most of the last 25 years, have required large federal subsidies to cover their losses in the crisis -- formalizing the implicit guarantee that has long contributed to their success. Meanwhile, the supply of credit to riskier borrowers also expanded during this period -- not as a result of CRA, as I have explained, but as a result of private securitization practices that turned out to be seriously flawed.

In the end, these public and private efforts helped to briefly push the homeownership rate as high as 69 percent. That's a level that ultimately proved unsustainable, and that may not be reached again for many years, if ever.

Even as we emerge from this crisis, it is worth asking whether federal policy is devoting sufficient emphasis to the expansion of quality, affordable rental housing. It is estimated that when you add up the mortgage interest deduction, local property tax deductions, and exclusions on capital gains realized on the sale of owner-occupied housing ... the taxpayer subsidies for homeowners are about three times the size of all rental subsidies and tax incentives combined.

In fact, you can argue that this huge subsidy for homeowners has helped push up housing prices over time, making affordability that much more of a problem for the very groups you're trying to serve. I think we need a better balance. Sustainable homeownership is a worthy national goal. But it should not be pursued to excess when there are other, equally worthy solutions that help meet the needs of people for whom homeownership may NOT be the right answer.

As a nation, we need to take a hard look at the full range of housing policies and programs. And we need to ask: will they improve standards of living for all Americans or just a few? And will our policies lead to sustainable improvements for the long term, or are they just a short term fix?

As recent events have shown, failure to review our policy goals and impose discipline on our programs can lead to skewed policies that create bigger problems down the road.

## **Conclusion**

If there is one message I can leave you with today, it would be that restoring our system of mortgage finance and securing our economic future cannot simply be done by fiat in Washington, D.C. There are many public policy challenges that need to be met. Financial regulators have to do a better job identifying and addressing emerging risks before they damage our economy. But it also takes a commitment by all of us – as homebuyers, market participants and regulators – to build and defend market practices that are designed to withstand adversity, and that protect the long term interests of consumers and the economy.

As better times come back to the U.S. housing and mortgage markets, as they inevitably will in the years ahead, we cannot forget the lessons of this crisis. And we must resist the temptation to cut corners or lower our guard. The most valuable legacy we can leave our children will be the kind of economic confidence and stability that can only come from making wise and prudent choices today. Thank you.

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